

Docket No: 12-0511
12-0512 (Cons.)
R.O.M.: 08/06/13
Deadline: 08/08/13

M E M O R A N D U M

TO: The Commission

FROM: Glenn Dolan and Sonya Teague, Administrative Law Judges

DATE: August 1, 2013

SUBJECT: North Shore Gas Company

Proposed general rate increase for gas distribution service.
(tariffs filed July 31, 2012)

The Peoples Gas Light and Coke Company

Proposed general rate increase for gas distribution services.
(tariffs filed July 31, 2012)

RECOMMENDATION: Grant in part and deny in part the applications for rehearing.

Background

The Public Utilities Act (the “Act”) provides, in pertinent part, that:

Within 30 days after the service of any ... order or decision of the Commission any party to the action or proceeding may apply for a rehearing in respect to any matter determined in said action or proceeding and specified in the application for rehearing. (220 ILCS 5/10 – 113).

This statute further provides that the Commission shall receive and consider such application and it “shall grant or deny such application in whole or in part within 20 days from the date of the receipt thereof by the Commission” *Id.* Further, no appeal is allowed from any order or decision “unless and until an application for a rehearing thereof shall first have been filed with and finally disposed of by the Commission.” Therefore, no party can appeal a Commission order without filing an application for rehearing. *Id.* Additionally, applications for rehearing must state with specificity the issues for which rehearing is sought. (83 Ill. Adm. Code 200.880(b)).

The Commission issued a final Order in this proceeding on June 18, 2013. North Shore Gas Company ("North Shore") and the Peoples Gas Light and Coke Company ("Peoples Gas") (collectively, the "Utilities"), the Citizens Utility Board ("CUB") and the City of Chicago ("City") (collectively, "CUB-City"), and the Attorney General (the "Attorney General" or "AG") timely filed applications for rehearing on July 19, 2013. Below is a summary of the arguments presented by each party.

The Utilities' Application for Rehearing

The Utilities seek rehearing only on three contested decisions contained in the Order. The three decisions relate to: (1) the investigation of Peoples Gas' Accelerated Main Replacement Program ("AMRP"), (2) corrections to the final Order's figures relating to the Utilities' 2012 and 2013 Net Operating Losses ("NOLs"), and (3) using the proper adjustments to implement the use of the partial flow through methodology to compute deferred income taxes related to the change in the state income tax rate. Additionally, as to the third subject, the Utilities seek clarification on the implementation of the partial flow through methodology.

AMRP Investigation

According to the Utilities, after the Commission issued its final Order in this proceeding, Governor Quinn signed into law Senate Bill 2266, which became PA 98-0057. PA 98-0057 allows a natural gas utility to file a tariff for a surcharge that adjusts rates and charges to provide costs associated with investments in qualifying infrastructure plant, such as AMRP. The law requires annual reconciliation proceedings with prudence review and a review of plant in the highest risk categories in the utility's Distribution Integrity Management Plan. 220 ILCS 5/9-220.3. PA 98-0057 also establishes an annual reporting requirement for certain data by the natural gas utility such as number of emergency calls and associated response times, incidents of damage, certain cathodic protection readings, and miles of main and numbers of services replaced that were constructive of various materials, such as cast iron. 220 ILCS 5/5-111(b). Under PA 98-0057, a natural gas utility must also submit an annual plan specifying its goals for each of the reporting items in Section 5-111(b) and show reasonable and continuing progress. 220 ILCS 5/5-111(d). The new law also provides that if the Commission finds that a utility has failed to show progressive improvement in its performance, the Commission may require the utility to submit a remediation plan to improve performance. 220 ILCS 5/5-111(d). Finally, PA 98-0057 also provides for two rulemaking proceedings to support the requirements of the new law. 220 ILCS 5/5-111(e) and 220 ILCS 5/9-220.3(a)(2). One of these rulemaking is an emergency rulemaking that must be completed in early August. *Id.*

The Utilities argue that given the extensive reporting requirements and stringent Commission oversight provided in PA 98-0057, the Commission's investigation is no longer necessary. The new law would make Peoples Gas accountable to the Commission and remediate its plan if it does not meet its specified goals for AMRP. Because Peoples Gas plans to file its tariff under PA 98-0057 no later than September 2013 to allow it to be in effect in early 2014, the tariff would become effective even

before the first phase of Staff's investigation contemplated in the final Order would be completed. The first Section 5-111 reports and plans are due April 1, 2014. Further, the resources, both in terms of workforce and the \$3.5 million needed for the investigation, a cost ultimately borne by ratepayers, can instead be invested in AMRP – keeping the plan on track without delay.

The Utilities also argue that the Commission decision to order the investigation is against the manifest weight of the evidence in this proceeding. The argument made in the rehearing petition is the same argument that was made during the hearings. There was no new information or other evidence presented by the Utilities to show that the ultimate conclusion was against the manifest weight of the evidence. However, if PA98-0057 requires the Utilities to provide extensive reporting requirements and be subjected to stringent Commission oversight as well as an annual reconciliation proceeding with prudence review, then maybe an investigation is not warranted. According to the Utilities, this new law would make Peoples accountable for the progress or lack thereof on an annual basis and the Commission would not have to wait until the next rate case filing to determine whether Peoples is accomplishing its goals under the AMRP. Since this law was only recently enacted, nothing has been filed concerning this Rider. It is difficult to determine whether this information is correct. If once the new Rider is in place and it is clear that the Commission has proper oversight on the AMRP, then the Company could petition the Commission to cancel or suspend the investigation approved in this Order. Therefore, we would recommend that rehearing on this issue be denied.

Corrections to the Final Order's Figures Relating to the Utilities' 2012 and 2013 NOLs.

The Utilities also request rehearing on the Utilities' 2012 and 2013 Net Operating Losses ("NOLs"). According to the Utilities, The Appendices to the final Order contain a couple of mathematical errors in how the 2012 and 2013 NOLs are reflected in rate base. Specifically, for North Shore, the amount on page 11, column (D), line 2 of Appendix A should be (\$1,050,000) and the amount on page 11, column (D), line 3 should be \$1,073,000. Further, page 11, Column (D), line 5 of Appendix A should be (\$1,050,000). The number currently reflected on line 5 is overstated by (\$1,048,000). Additionally, for Peoples Gas, the amount on page 12, column (D), line 2 of Appendix B should be (\$10,300,000) or 50% of the effect of the federal income taxes related to the revenue increase of (\$20,598,000). Further, page 12, Column (D), line 5 of Appendix B should be (\$10,300,000). The number currently reflected on line 5 is overstated by (\$24,170,000) as it double counts the average rate base adjustment (by \$13,872,000) and double counts the "effect of rate increase" adjustment (by \$10,300,000). These corrections also should be reflected in all affected rate base and revenue requirement figures. See Attachment A and B for corrected page 11 of Appendix A and corrected page 12 of Appendix B.

In reviewing this issue, it appears that some of the information that is necessary to calculate the correct amount of the 2012 NOL is not contained in the record.

Therefore, we would recommend rehearing for the purpose of determining the correct amount of the 2012 NOL that should be included in rate base.

Methodology to Reflect Change in State Income Tax Rate

The Utilities requested rehearing on the final Order's adoption of the AG computation of the adjustments to reflect the use of the partial flow-through method for deferred income taxes related to the change in state income taxes. According to the Utilities, even though they continue to disagree that good cause has been shown to deviate from the Average Rate Assumption Method ("ARAM") to account for deferred taxes related to a change in income tax rate the Utilities generally do not seek rehearing on the decision to adopt the partial flow through method. However, the Utilities do seek (1) rehearing on the appropriate adjustments to implement the partial flow through method and (2) clarification on the implementation of the partial flow through method.

While the Utilities do not agree with the conclusion reached on this issue, there really has not been any new or additional evidence or information presented to warrant rehearing on this issue.

CUB-City's Application for Rehearing

CUB-City seek rehearing on the Order's determinations on the following issues: (1) Utilities' 2012 NOLs, (2) the Utilities' projected expenses related to the operations and maintenance ("O&M") cost control metric in the Utilities' incentive compensation plan, (3) the vacancy adjustment proposed by CUB-City, (4) the forecasted expenses related to the legacy sewer cross bore program ("Cross Bore Program"), (5) the projected expenses related to compliance with new Chicago Department of Transportation ("CDOT") regulations, (6) the methodology used for computing invested capital tax ("ICT") and its derivative adjustments, and (7) the rate designs proposed for the residential classes.

2012 NOLs

CUB-City has requested rehearing on the inclusion of the 2012 NOL in the Companies' revenue requirement. According to CUB-City, the Companies were aware of the 2012 NOL earlier in the case and waited until the surrebuttal stage to change their position on this issue. CUB-City also argue that the Companies' explanation as to why it changed its position is not true and would not have made a difference on this issue. CUB-City state that the closing of the 2012 books and the American Taxpayers Relief Act of 2012 passed in early 2013 does not make a difference on this issue.

As stated in the section on the Utilities' application for rehearing, we recommend that rehearing on this issue be granted for the purpose of reflecting the proper amount of 2012 NOL to be included in rate base. We recommend that the Commission deny CUB-City request on this issue since it is necessary to include the 2012 NOL in rate base.

Incentive Compensation

CUB-City argue that the decision in the final Order approving the Utilities' projected expenses related to the operations and maintenance ("O&M") cost control metric lacks a substantial basis in the record, does not produce just and reasonable rates as required by the Act, and does not articulate a reasoned analysis of the relevant evidence. CUB-City maintain that the evidence shows the cost control metric is not effective and that it will result in double recovery of costs. Additionally, CUB-City state that the decision is also erroneous because the Utilities should be required to demonstrate tangible net benefits to customers to justify recovery of the forecasted incentive compensation costs and the metric is based on the performance of all Integrys Energy Group Inc. affiliates and not solely on the Utilities' performance.

This is the same argument previously made by CUB-City which was thoroughly addressed in the final Order. CUB-City have not presented any new evidence or information that would warrant rehearing on this issue.

Vacancy Adjustment

CUB-City contend that the conclusion in the final Order rejecting the vacancy adjustment proposed by CUB-City is unrealistic, against the manifest weight of the record evidence and allows the Utilities to recover costs that they will not incur. CUB-City state that the final Order's conclusion assumes there will be no vacancies for the entire test year which is unrealistic because in any large business there will be some vacant positions at any given time.

CUB-City have not offered any new evidence or information on this issue but instead reiterated their previous arguments. Accordingly, rehearing on this issue should be denied.

Cross Bore Program

CUB-City argue that the Commission should grant rehearing to analyze the evidence presented by Staff witness Darin Burk to reconsider whether Peoples Gas replaced its pipelines prudently or whether the costs of the Cross Bore Program could or should have been avoided entirely. CUB-City contend that if the Utilities' procedures were inadequate or not followed, the costs of this program should not be borne by ratepayers. Additionally, CUB-City argue that if the Commission does not reverse its allowance of these costs, at the very least, more evidence should be received on this issue, and the Commission should grant rehearing to conduct further investigation.

The final Order adequately and appropriately addressed this issue. CUB-City have not presented any new evidence or information that would warrant rehearing on the Cross Bore Program.

New CDOT Regulations

CUB-City argue that the final Order incorrectly concludes that the Utilities' estimate of test year expenses to comply with new CDOT regulations are reasonable and supported by the evidence. It is CUB-City's opinion that the evidence indicates that Peoples Gas' actual expenses (annualized) were significantly lower than the estimate offered as test year costs and Peoples Gas' testimony does not explain how an annualized actual expense of about \$3.5 million was legitimately increased to more than \$13 million. CUB-City urge the Commission to reconsider whether compliance with CDOT's regulations will cause Peoples Gas to incur more than \$13 million in costs. Accordingly, CUB-City state that the Commission should reconsider its determination and instead adopt CUB-City's proposed adjustment reducing the Utilities' distribution O&M expenses by \$10,454,372.

CUB-City have not offered any new evidence or information on this issue but instead reiterated their previous arguments. Accordingly, rehearing on this issue should be denied.

Invested Capital Tax Computation and Derivative Adjustments

CUB-City argue that the Commission should reconsider the final Order's acceptance of the Utilities' calculation of their test year ICT expense. According to CUB-City, two accountants in this case, CUB-City witness Ralph Smith and AG witness Michael Brosch, presented evidence that the Utilities' methodology does not comport with accounting and ratemaking principles, which require consideration of only test year costs in setting rates. Additionally, CUB-City maintain that since the Utilities chose a 2013 test year, the appropriate calculation of the ICT expense (as specified by the pertinent taxing authority) uses the beginning and ending balances from the prior year, 2012, which is the amount that the Utilities will actually pay in the 2013 test year.

This is the same argument previously made by CUB-City which was thoroughly addressed in the final Order. CUB-City have not presented any new evidence or information that would warrant rehearing on this issue.

Service Classification Rate Design

CUB-City take issue with the rate design approved in the final Order for residential heating and non-heating customers. According to CUB-City, the rate design approved by the Order is flawed because it was built primarily on the Utilities' false premise that most, if not all, of the Utilities' costs are fixed despite the fact that the Utilities' own Embedded Cost of Service Studies ("ECOSSs") show that a significant portion of their costs of service vary with the amount of gas that customers use. CUB-City also assert that the approved rate design rest on the equally false assumption of homogeneity within residential heating and non-heating subclasses. They argue the bifurcation of the residential class into heating and non-heating sub-classes only partially addresses the effect of the variance in customer usage and cost-causation principles. CUB-City urge the Commission to reconsider the approved rate design and

adopt the alternative proposal recommended by the AG which more closely adheres to the cost of service responsibilities identified by the Utilities' ECOSSE.

This is the same argument previously made by CUB-City which was thoroughly addressed in the final Order. CUB-City have not presented any new evidence or information that would warrant rehearing on this issue.

The AG's Application for Rehearing

The AG seeks rehearing on a number of contested issues including: (1) Construction Work in Progress ("CWIP"), (2) Pass-Through Taxes Cash Working Capital, (3) 2012 NOLs, (4) AMRP Repairs Deduction, (5) the Utilities' projected expenses related to the O&M cost control metric in the Utilities' incentive compensation plan, (6) the AG's proposed productivity adjustment, (7) the forecasted expenses related to the Cross Bore Program, (8) the projected expenses related to compliance with new CDOT regulations, (9) the vacancy adjustment proposed by the AG, (10) the rate designs proposed for the residential classes, and (11) the continuation of Rider VBA.

Construction Work in Progress

The AG filed an application for rehearing on the issue of to include Construction Work in Progress ("CWIP") in the test year rate base that the Company has not shown will be used and useful in 2013. According to the AG, Peoples has not shown that this CWIP associated with the Accelerated Main Replacement Project ("AMRP") will be placed into service by the relevant timeframe required by Section 9-214 of the Act. The AG points to the testimony of their expert Mr. Efron to support their position for rehearing. This is the same argument that the AG put forth in their testimony and in their briefs. Staff did not agree with this proposed adjustment.

There has been no new or additional evidence presented to warrant rehearing on this issue. Therefore, we recommend that rehearing on this issue be denied.

Pass-Through Taxes Cash Working Capital

The AG has requested rehearing on the alternative adjustment to the Companies request to incorporate a revenue lag in its Cash Working Capital ("CWC") calculation for the Pass-Through Taxes. This was the alternative approach adopted in the final Order. According to the AG, this alternative method is no different than the original approach taken by the Companies. The Staff of the Commission did not object to this method after cross examination during the hearing.

There has been no new evidence or information provided by the AG to warrant rehearing on this issue. Therefore, we recommend that rehearing on this issue be denied.

2012 NOLs

The AG has requested rehearing on the 2012 Net Operating Loss (“NOL”) that was included in the Companies’ revenue requirement. According to the AG these losses are not properly explained by the Companies. With the passage of the American Taxpayers Relief Act of 2012 in January 2013, the Companies adopted the position to include this in the revenue requirement. The inclusion of the NOL was reasonable and consistent with the prior Commission Order in the last Peoples/North Shore rate case. The AG attempts to point out an inconsistency in the conclusion on this issue. Staff did change their position in their reply brief on the 2012 NOL stating that there is not sufficient information in the record to make a determination as to the proper amount to be included in the revenue requirement.

As stated in the section on the Utilities’ application for rehearing, we recommend that rehearing on this issue be granted for the purpose of reflecting the proper amount of 2012 NOL to be included in rate base. We recommend that the Commission deny AG’s request on this issue since it is necessary to include the 2012 NOL in rate base.

AMRP Repairs Deductions

The AG argues that the Commission should grant rehearing on this issue because the record does not support the conclusion. According to the AG, Peoples reversed its decision mid-way through this docket and decided not to take repairs tax deduction associated with AMRP related projects. The AG cites to its initial and reply briefs to support their position for rehearing. CUB and the Staff of the Commission did not agree with the AG’s position on this issue.

The AG has not presented any new arguments or evidence to warrant rehearing on this issue. Therefore, we recommend rehearing on this issue be denied.

Incentive Compensation

The AG argues that the Commission should reconsider the inclusion of forecasted expenses associated with the Utilities’ O&M cost control metric. The AG contends that the Utilities failed to show a nexus between the incentive compensation costs included in the test year forecast and specific, identifiable benefits to the Utilities’ ratepayers. According to the AG, incentive payments to employees in 2013 for which rate recovery is desired must be tied to incremental cost savings in 2013, none of which are reflected in the Utilities’ test year rate case forecasts. Additionally, the AG argues that references in the final Order to the Commission’s Order in Docket No. 07-0241/0242 miss the mark because the incentive compensation plans approved in that rate case order did not involve affiliate-wide incentive compensation like the plan at issue in this case.

This is the same argument previously made by the AG which was thoroughly addressed in the final Order. The AG has not presented any new evidence or information that would warrant rehearing on this issue.

Productivity Adjustment

The AG urges the Commission to reconsider its conclusion rejecting the AG's productivity adjustment. The AG argues that contrary to the final Order's conclusion, adopting the AG's proposed productivity adjustment does not require an affirmative showing of "inefficiencies or missed opportunity." The AG maintains, however, that the issues driving its proposed adjustment are whether or not to forecast only inflation, higher wage rates, higher staffing levels and increased capital spending when setting rates, all the while assuming that utility management is unable to find incremental ways to improve efficiencies each year. The AG states that its proposed productivity adjustment is essential if the Commission allows recovery of expenses related to the Utilities' O&M cost control metric.

The AG has not offered any new evidence or information on this issue but instead reiterated its previous arguments. Accordingly, rehearing on this issue should be denied.

Cross Bore Program

The AG asserts that the conclusions of the final Order rejecting the AG-sponsored adjustment to the Cross Bore Program expenses included in test year revenue requirements are unsupported by the record evidence and faulty in logic. While the AG acknowledges that the Cross Bore program has the potential to be beneficial; it maintains that the Utilities have not demonstrated a level of commitment to this program and have failed to demonstrate that the expenditures included in the test year related to the program are reasonable in amount and likely to occur. Accordingly, the AG urges the Commission to grant rehearing on this issue and to reject the additions to test year expenses for this program because it is highly speculative.

This is the same argument previously made by the AG which was thoroughly addressed in the final Order. The AG has not presented any new evidence or information that would warrant rehearing on this issue.

New CDOT Regulations

The AG argues that the Commission should reconsider the final Order's decision to allow forecasted expenses related to new CDOT regulations to be included as an O&M expense. It is the AG's position that the record evidence shows that the compliance requirements have not been resolved and the cost of compliance is still being negotiated. Accordingly, the AG maintains that the Commission should revisit this issue on rehearing and adopt the AG's adjustment because the record does not support the Utilities' projected expenses.

This is the same argument previously made by the AG which was thoroughly addressed in the final Order. The AG has not presented any new evidence or information that would warrant rehearing on this issue.

Vacancy Adjustment

The AG argues the decision in the final Order denying its proposed vacancy adjustment should be reconsidered on rehearing because the Utilities have failed to justify underlying assumptions in their labor forecasts. The AG maintains that it proposed a reasonable adjustment to account for inherent realities involving natural turnover and the amount of time it takes to re-staff vacant positions. The AG contends that the Commission's final Order does not reflect the reality that some vacancies will occur during the test year. Accordingly, the AG urges the Commission to grant rehearing on this issue and adopt the AG's proposed vacancy adjustment.

The AG has not offered any new evidence or information on this issue but instead reiterated its previous arguments. Accordingly, rehearing on this issue should be denied.

Rate Design

The AG takes issue with the final Order's adoption of Staff's proposal to increase the recovery of non-storage related fixed costs from 67% to 68% through the customer charges for North Shore and from 54% to 61% for Peoples Gas. It is the AG's position that this decision is inexplicable and should be reconsidered on rehearing. The AG contends that the Utilities' own ECOSs shows that the Utilities' costs are not all fixed, however, the final Order erroneously continues the march toward greater recovery of costs through the fixed monthly customer charges. The AG argues this decision is inexplicable because the substantial evidence in the record shows that demand-related costs account for 38% of Peoples Gas' and 32% of North Shore's total cost of serving residential heating customers. Additionally, the AG states that the final Order's adoption of a bifurcation of the residential class into heating and non-heating subclasses is not enough to address the existing cross-subsidy between low and high users of natural gas.

The AG has not offered any new evidence or information on this issue but instead reiterated its previous arguments. Accordingly, rehearing on this issue should be denied.

Rider VBA

The AG argues that notwithstanding the Second District's appellate ruling in which it affirmed the Commission's approval of Rider VBA on a permanent basis, the AG continues to believe that the evidence does not support the continuation of Rider VBA. The AG contends that none of the presumed rationales for approving Rider VBA in the Utilities' previous rate case is supported by the facts in this record and that the Utilities' own ECOSs support the recoupling of usage and price. The AG maintains that the fundamental flaw in the Commission's adoption of Rider VBA is that it treats demand-related costs as "fixed" even though they are incurred based on the amount of gas customers use. Additionally, the AG argues the recently enacted law, PA-98-0057, virtually eliminates the regulatory lag associated with the major operational costs associated with running a natural gas delivery service utility, therefore, the

notion that the Utilities' recovery of fixed costs are at risk is not credible. For these reasons, the AG urges the Commission to reconsider its adoption of Rider VBA as a permanent rider on rehearing in light of the facts in this record.

The AG has not provided sufficient facts to establish the relevance of PA-98-0057 to Rider VBA. PA-98-0057 is a new law and it is unclear how it will be implemented, moreover it only concerns recovery of costs associated with replacement of natural gas delivery service legacy mains and associated infrastructure which is only one of many components of the Utilities' operational costs. Additionally, the Utilities have not filed tariffs pursuant to PA 98-0057, therefore, it is not currently possible to know exactly how any such tariffs might operate. The AG's argument is therefore unpersuasive. The additional arguments presented by the AG are all the same arguments presented previously which have been thoroughly addressed in the final Order. Thus, no purpose would be served by granting rehearing on this issue.

Therefore, we recommend that the Utilities' applications for rehearing on the 2012 NOL be granted and all other requests be denied. The deadline for Commission action on the applications for rehearing is August 8, 2013.

GPD/ST:fs